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QUESTION PRESENTED

Respondents hold a claim against petitioner, a chapter 7 debtor, that has been fully allowed and that is secured by a lien on petitioner's property. The property has been abandoned by the trustee in bankruptcy. The question presented is whether petitioner is entitled under Section 506(d) of the Bankruptcy Code to reduce respondents' lien to the value of the property as determined by the bankruptcy court prior to any foreclosure sale.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-741

ALETHA DEWSNUP,

Petitioner,

v.

LOUIS L. TIMM, JOHN NEIUWLAND and FLOYD M. CHILDS, Trustees of the UNITED PRECISION MACHINE AND ENGINEERING COMPANY PROFIT-SHARING TRUST, ABCO INSURANCE AGENCY, INC., and JOSEPH L. HENROID, as Trustee for the Annette Jacob Trust,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

BRIEF FOR THE RESPONDENTS

STATEMENT

Petitioner borrowed money from respondents and has not paid her debt. As security for the debt, respondents obtained a lien on certain farmland of petitioner's—a lien that, under Utah law and the security agreement, gave respondents a right to proceed against the property when petitioner defaulted. The court of appeals held that Section 506(d) of the Bankruptcy Code, 11 U.S.C. § 506(d), did not abrogate that state-law property right.

1. *Background.* On June 1, 1978, petitioner, together with her now-deceased husband, borrowed $119,000 from

respondents. The debt was secured by trust deeds on two farm parcels, neither of which was petitioner's principal residence. Respondents are the beneficiaries of the trust.[1]

The deed of trust states that, if the borrowers default on their obligations, respondents are entitled to declare the full amount due, to issue a notice of default, and (after an appropriate interval) to have the parcels sold at a public auction to the highest bidder, with the proceeds to satisfy the debt owed to respondents (as well as certain other expenses). Deed of Trust ¶¶ 14, 15. The deed is governed by Utah law. Utah statutes mirror the deed provisions granting respondents the right to proceed against the property to collect amounts owed on the loans. Utah Code Ann. §§ 57-1-20 to 57-1-37 (1990).

Petitioner defaulted in 1979.[2] Respondents exercised their rights under the deed of trust and, pursuant to Utah law, gave petitioner 90 days to cure the default, which petitioner failed to do. *See* Utah Code Ann. § 57-1-31. In a state court action, respondents then obtained a judgment confirming petitioner's remaining debt to respondents. J.A. 15.[3] Respondents thereupon gave notice of a non-judicial sale to enforce their lien.

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[1] The deed of trust and promissory notes have been lodged by petitioner with the Clerk of the Court. (ABCO Insurance Agency, the only corporation among respondents, has no parent company and no subsidiaries except wholly owned subsidiaries. *See* Sup. Ct. R. 29.1.)

[2] For simplicity's sake, we hereafter refer only to petitioner, rather than jointly to petitioner and her late husband.

[3] Although petitioner repaid the original principal and interest on the $119,000 loan in late 1980, she remained indebted to respondents for approximately $50,000 in taxes and other expenditures that respondents were forced to make in order to protect their security on a third piece of property. The state court held that those expenditures were covered by the security agreement involving the two farm parcels at issue here. That ruling was not disturbed by the courts below and is not at issue in this case.

In April 1981, before the sale could take place, petitioner filed for bankruptcy protection, seeking reorganization under chapter 11 of the Bankruptcy Code. That filing stayed the property sale. 11 U.S.C. § 362. The 1981 petition was dismissed in 1982, and a second chapter 11 petition was dismissed with prejudice in 1984.[4] Petitioner thereupon filed the present liquidation petition under chapter 7 in June 1984. The successive petitions prevented respondents from exercising their rights under the deed of trust and completing any foreclosure sale.

2. *This Litigation.* After almost three years, petitioner filed a complaint in this chapter 7 case asking the bankruptcy court to divest respondents of their right to proceed against the property. J.A. 3-9. In particular, petitioner sought a declaration, first, that respondents' lien was valid only to the extent of the judicially determined value of the farm parcels and, second, that petitioner could redeem the parcels for that amount.[5] Petitioner argued that she was entitled to that relief under Section 506(d) of the Code, 11 U.S.C. § 506(d), even

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[4] *See* Findings of Fact, Conclusions of Law, and Order Regarding Dismissal of Case with Prejudice, *In re Lamar Dewsnup et al.*, Bankruptcy Case No. 82C-02046 (Bankr. D. Utah Feb. 16, 1984). The order, after reciting petitioner's repeated failure to propose a reorganization plan, precluded the filing of any further bankruptcy petitions under either chapter 11 or chapter 13. *Id.* at 9.

[5] As petitioner acknowledges (Pet. Br. 6), and as the opinions of the bankruptcy court and the court of appeals make clear, throughout this litigation petitioner has treated her lien-reduction claim as encompassing her claim for redemption of the property. *See* II R.O.A. 17-18 (trial brief of petitioner). Although she now pursues only her claim to lien reduction and has dropped her request for a declared right of redemption (*see* Pet. 12), in the court of appeals she treated the issues as inseparable, asserting that she sought the right to "avoid liens and effectively redeem real property." Br. of Appellant 5; *see also id.* at 4, 7.

though she had no such rights under Utah law. Pet. App. 3a, 16a-17a.[6]

Section 506(d) declares, with exceptions not applicable here: "To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void." 11 U.S.C. § 506(d). Subsection (a) of Section 506 in turn states: "An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . ." 11 U.S.C. § 506(a). In petitioner's view, those provisions apply to respondents' lien and thus make the lien void over and above the judicially determined value of the property—the "allowed secured claim."

In June 1987, the bankruptcy court held a trial to determine the value of the farm parcels and found that they were worth $39,000. *See* Pet. App. 16a. The parcels were accordingly worth less than the lien, which, with interest on the outstanding debt, had a value of roughly $120,000 by mid-1988.[7] Because the estate could not receive any net benefit from liquidation of the property, in July 1988 the trustee abandoned "any interest that the estate may have in and to said property." J.A. 24. The trustee acted

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[6] Nothing in Utah law voided any part of the lien. Although Utah law would have allowed petitioner to buy the parcels within three months of the notice of default (Utah Code Ann. § 57-1-31), she failed to exercise that right. Utah law provides no right of redemption *after* a trustee's sale, though it does provide for redemption after a judicial mortgage-foreclosure sale. *Jones v. Johnson*, 761 P.2d 37 (Utah Ct. App. 1988); *see* Utah Code Ann. § 57-1-28(2) (no redemption right after trustee's sale), § 78-37-6 (mortgage foreclosure redemption right).

[7] Petitioner did not explicitly challenge the validity of her remaining debt. She argued, however, that all of her debt that was secured by the farmland had been satisfied. J.A. 4, 16. The bankruptcy court implicitly rejected even that contention. There is no doubt, therefore, that respondents' claim had been fully allowed under 11 U.S.C. § 502.

pursuant to 11 U.S.C. § 554(a), which authorizes abandonment of "any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate."

Meanwhile, in June 1988, the bankruptcy court issued its opinion on petitioner's request for a declaration that Section 506(d) rendered respondents' lien void in excess of $39,000. Pet. App. 16a-31a. Assuming in the opinion that the property either had been or was about to be abandoned by the trustee (*id.* at 17a n.1), the court held that Section 506(d) of the Code did not apply to the abandoned land, so that petitioner was entitled neither to redeem the property for $39,000 nor to receive any excess over $39,000 (less sale costs) that the land would bring at a (non-judicial or judicial) foreclosure sale. The court concluded that the property, having been abandoned and thus deprived of any further role in the administration of the estate, was no longer property of the estate and, therefore, the lien was not on "property in which the estate has an interest" under Section 506. Pet. App. 28a, 31a.

The court explained that any other interpretation would give petitioner more than she would receive outside bankruptcy. Petitioner's view would strip respondents of their right to force a sale (subject to any state-law redemption rights) and either buy the property themselves or collect the sale price (less sale expenses) up to the value of the outstanding secured debt. Pet. App. 30a. Petitioner's position would simply give her a windfall, for no purpose related to the function of Section 506: once completely abandoned, the farmland would play no part in "facilitat[ing] the administration and distribution of the bankruptcy estate." Pet. App. 29a; *id.* at 28a. The bankruptcy court dismissed petitioner's claim for relief under Section 506, leaving respondents with their state-law rights to proceed against the property. Pet. App. 14a-15a.

3. *The Court of Appeals' Decision.* The district court affirmed the bankruptcy court's dismissal of petitioner's complaint (Pet. App. 12a-13a), and the court of appeals affirmed (*id.* at 1a-11a). The Tenth Circuit, while relying heavily on the bankruptcy court's reasoning, also explained that petitioner's view of Section 506 was inconsistent with Section 722 of the Code. Pet. App. 9a-10a. In that provision, Congress expressly provided debtors a federal right to redeem certain abandoned property, but it limited the right to certain kinds of personal property, thus excluding petitioner's land. Yet allowing lien reduction under Section 506, the court of appeals reasoned, would—as petitioner has often acknowledged in this case (*see* note 5, *supra*)—effectively give the debtor the same right to redeem land that Congress excluded from Section 722. Pet. App. 10a.

Recognizing that the Third Circuit had recently adopted petitioner's view of Section 506 in *Gaglia v. First Fed. Sav. & Loan Ass'n*, 889 F.2d 1304 (1989), the court of appeals in the present case criticized *Gaglia* for failing to appreciate that its reading of Section 506 made the provision the functional equivalent of a federal redemption provision far broader than Section 722. Pet. App. 3a, 10a. The court also explained that, at bottom, the Third Circuit had relied on the erroneous view that use of Section 506 to strip down respondents' lien reproduced the result that would occur outside bankruptcy. In fact, the Tenth Circuit explained, a reversion of the property to pre-bankruptcy status—which is what occurs upon abandonment (Pet. App. 5a)—would not limit the lienholders' recovery to the judicially determined price; it would give the lienholders the right to purchase the property themselves or to have it sold to the highest bidder (subject to any state-law redemption rights), with the lienholders collecting the sale price up to the amount they are still owed. The Third Circuit's reading of Section 506 strips lienholders of some of this state-law entitlement,

even though the property plays no role in the bankruptcy. Pet. App. 7a-8a, 10a-11a.

INTRODUCTION AND SUMMARY OF ARGUMENT

Petitioner's reading of Section 506(d) treats that subsection as rigidly tied to subsection (a). In her view, once Section 506(a) has declared, for an allowed claim that is secured, how much of the claim is to be treated as secured and how much as unsecured for distribution purposes, Section 506(d) effects the same bifurcation of the lien on the secured property. Thus, petitioner proposes that Section 506(d) voids a lien whenever, and to the extent that, the lien exceeds the amount of the "allowed secured claim"—here, $39,000—that is set by Section 506(a). Pet. Br. 13-14.

Petitioner's reading of Section 506(d) has one, but only one, virtue: simplicity. That virtue, however, is not enough to sustain it as a proper conclusion about what Section 506(d) means. To the contrary, judged in light of pre-Code law and other provisions of the Code, petitioner's view simply could not have been what Congress intended.

Thus, pre-Code bankruptcy law preserved liens like respondents' lien, yet the Code's legislative history not only fails to reflect any intent to alter that longstanding practice but indicates a congressional intent to continue it. It has likewise been longstanding bankruptcy policy to avoid impairments of state-law property rights without a clear justification in bankruptcy functions. Here, the sole bankruptcy policy petitioner invokes—the "fresh start" policy—cannot justify impairing respondents' property rights as she urges: the fresh start contemplated by the Code does not extend to *in rem* claims against property but is limited to a discharge of *personal* liability, where, as here, the debtor has no protected interest in possession of the property. Moreover, petitioner's view of Section 506(d) would give her a re-

demption right even though Congress specifically denied her such a right when it addressed redemption in Section 722 of the Code. In addition, petitioner's view of Section 506(d) would give her the benefit of a voided lien even though Section 551 of the Code preserves liens for the benefit of the *estate*. Her view also would give her this benefit under chapter 7 even though she could not claim the same benefit under chapter 11, a result that would undermine the congressional preference for reorganizations over liquidations. Against this background, it is not surprising that, contrary to petitioner's argument, the text of Section 506(d) neither must nor should be read to reduce liens like respondents' to the judicially determined value of the collateral set by the court, prior to foreclosure, for purposes of Section 506(a).

First, as the court of appeals concluded, subsection (d) is inapplicable to a lien on property that is not the estate's property. It is clear, as an initial matter, that Section 506(d) cannot impair all liens on all property securing allowed secured claims against the debtor, for the Code does not impair liens on property of third parties, even if that property is pledged to secure a claim against the debtor. Petitioner herself therefore accepts the court of appeals' assumption that subsection (d) implicitly must be limited to "property in which the estate has an interest" (11 U.S.C. § 506(a)). *See* Pet. Br. 13-14, 25-28. What petitioner fails to recognize is that complete abandonment of the property, as occurred in this case, strips the estate of the required "interest" in the property, thus rendering Section 506(d) inapplicable.

This reading properly separates subsection (a) from subsection (d) by focusing on the relation of the collateral to the bankruptcy estate at different times and for different purposes. The lien-voiding subsection, since it is directed at lienholders' foreclosure powers, is addressed to the time at which such foreclosure is to take place: if the estate has abandoned any interest in the

collateral prior to that time, there is no basis in any bankruptcy function for thereafter invoking subsection (d) to give some of the lienholders' rights to the debtor. By contrast, subsection (a) performs the function of classifying claims in order to fix, for distribution purposes, the obligations of the estate to both secured and unsecured claimants; that provision is properly read as setting the amounts of the secured and unsecured portions of a claim while the estate still has its interest in the collateral, regardless of any later abandonment. So read, subsection (a) continues to furnish the "allowed secured claim" and "allowed unsecured claim" even for collateral that is abandoned and hence outside subsection (d).

Second, while the court of appeals' interpretation of Section 506(d) focuses on the nature of the collateral and its relation to the bankruptcy estate, a focus on the nature of respondents' *claim* reveals an additional reason why Section 506(d) need not, and should not, be read to produce the result petitioner urges. Thus, Section 506(d) may be read to void a lien only "[t]o the extent that" the claim it secures has not been allowed. Under this reading, subsection (d), in declaring a lien void "to the extent that [it] secures a claim against the debtor that is not an allowed secured claim," does not use "allowed secured claim" as if it were an indivisible phrase "defined" by subsection (a)—which, after all, is not by its terms a definitional section. Rather, the phrase in subsection (d) can and should be read term by term in its ordinary sense: the claim secured by the lien is an allowed secured claim under subsection (d), and the provision is for that reason inapplicable, if the claim is secured and the claim has been allowed, both of which are true in this case. A lien is void, under this permissible reading of the statutory language, precisely "[t]o the extent that" the claim it secures has been disallowed —here, not at all.

Third, if, contrary to our submission, the Court concludes that Section 506(d) applies here, the provision nevertheless should not be held to have the effect that petitioner suggests: that is, it should not be read as treating the judicially determined value of the collateral as placing a permanent ceiling on respondents' lien. Thus, if the Court concludes that Section 506(a) does *not* permanently establish the bifurcation of a claim in secured and unsecured portions prior to the collateral's abandonment, then the provision must be read as authorizing an adjustment of the judicially determined value of the collateral to reflect any higher value actually obtained at a foreclosure sale (whether from third parties or from the lienholders themselves). Absent a good reason not to effect such an adjustment, the foreclosure price is the most accurate, and fairest, value to use for deciding how much of a claim is secured and how much is unsecured. It follows, upon such an adjustment of the "allowed secured claim," that the surviving lien is adjusted to reflect the foreclosure price as well. Under this reading, as under the others, the 1987 judicial valuation does not place a permanent cap on respondents' *in rem* charge against the property.

Many of the structural, historical, and other arguments for why Section 506(d) does not authorize petitioner's proposed lien-stripping—why petitioner is not entitled to the windfall she seeks and respondents not obliged to accept the abrogation of their state-law property rights—apply equally to support all three of the reasons for rejecting petitioner's reading of Section 506(d). For simplicity's sake, however, we proceed in the main argument by setting out in full why this Court should adopt the court of appeals' reading of Section 506(d) as inapplicable to petitioner's property because it has been completely abandoned. The two additional reasons for rejecting petitioner's construction are then set forth briefly, in sections that incorporate the pertinent arguments articulated in full in defense of the court of appeals' reading.

ARGUMENT

SECTION 506(d) OF THE BANKRUPTCY CODE DOES NOT LIMIT RESPONDENTS' LIEN ON PETITIONER'S PROPERTY TO A VALUE DETERMINED BY THE COURT PRIOR TO A FORECLOSURE SALE.

The property of the debtor, petitioner here, has been judicially determined to have a value far less than the amount of the lien on that property held by the secured creditors, respondents here, whose claim against petitioner has been fully allowed. The property has been abandoned by the trustee and hence will play no role in this liquidation proceeding. The property will be sold at a foreclosure sale after the bankruptcy stay is lifted under Section 362 or the case is closed under Section 350. The question presented is whether the judicially assigned value of $39,000 (plus appropriate interest) places a ceiling on the secured creditors' interest in the property at the foreclosure sale, when the property is sold either to third parties or to respondents themselves (through bidding their claim at the sale).

Petitioner's position is that, once the court has valued the property, the lien is permanently stripped down to that value. For example, if a foreclosure sale were to bring $60,000, petitioner asserts a right to be written a check for $21,000 (minus appropriate interest and sale expenses), even though respondents still have not been paid a large part of the debt that is secured by that property.[8] Petitioner claims that Section 506(d) of the Bankruptcy Code achieves that result by depriving respondents of their full state-law right to payment of their debt out of the abandoned property. That view is incorrect: Con-

[8] Respondents have not received any distribution on the unsecured portion of their claim, and there is no indication that they will receive any such distribution, because, from all that has appeared throughout this extended liquidation proceeding, there are no assets to distribute in payment of unsecured claims in this case.

gress did not intend, in Section 506(d), to give petitioner the windfall she seeks or to abrogate respondents' state-law property rights.

I. The Court of Appeals Correctly Held Section 506(d) of the Bankruptcy Code Inapplicable to Respondents' Lien on Petitioner's Property Because the Property Has Been Abandoned by the Trustee.

Section 506(d) of the Bankruptcy Code declares: "To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void," unless no proof of claim was filed or the claim was disallowed under provisions dealing with unmatured support payments or rights of contribution. 11 U.S.C. § 506(d). Petitioner herself does not propose a literal reading of the provision. Thus, she accepts the court of appeals' assumption that, in order for Section 506(d) to apply to a lien, the lien must be, at a minimum, on "property in which the estate has an interest" (11 U.S.C. § 506(a)), a phrase that does not appear in subsection (d). *See* Pet. Br. 13-14, 25-28 (arguing that the scope of subsection (a) governs subsection (d) and that abandoned property *is* "property in which the estate has an interest").

It is plainly correct that Section 506(d) cannot have the effect—which would be its effect if read literally—of impairing liens on *all* property securing a secured claim against the debtor. If that were the case, Section 506(d) would impair, for example, liens running against *third parties'* property that has been pledged as additional security for a secured claim against the debtor. Under well-established law, however, distinct property interests that are not the *debtor*'s interests at all, and hence not the estate's property interests, are unprotected by bankruptcy law, including Section 506. "[I]f the debt is secured by property of a third party that property can be reached to the full extent of the security agreement."

R. Jordan & W. Warren, *Bankruptcy* 211-12 (2d ed. 1989).[9] That principle would be violated if Section 506(d) were read literally to apply to any lien securing an allowed secured claim against the debtor.[10]

Accepting that Section 506(d) thus cannot apply to all property securing a secured claim against the debtor, petitioner correctly follows the court of appeals' assumption that Section 506(d) is implicitly limited to "property in which the estate has an interest." Petitioner then errs, however, in believing that abandoned property falls within that phrase. In fact, as the court of appeals held, collateral like petitioner's, which has been completely abandoned by the trustee, is not property in which the estate has an interest and, like property held by third parties, therefore is not subject to the operation of Section 506(d). Pet. App. 6a.

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[9] Section 524(e) of the Code states that, with certain narrow exceptions, "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." 11 U.S.C. § 524(e). Similarly, Section 362 stays foreclosure actions only against the *debtor*'s property, not against property of a third party. 11 U.S.C. § 362(a). And the Code's several provisions giving distinctive treatment to third parties who have secured the bankrupt's debt (*e.g.*, 11 U.S.C. §§ 502(e), 509, 506(d)(1)) all rest on the premise that the creditor's lien on a third party's property is unaffected by the bankruptcy—and so can be foreclosed on by the creditor while the bankruptcy proceeding is under way. *See* 3 L. King, *Collier on Bankruptcy* ¶ 502.05, at 502-83 to -93 (15th ed. 1991) [hereafter "*Collier* —— (15th ed.)"] Under pre-Code bankruptcy law, too, a creditor whose claim against the debtor was collateralized by property of a third party was not, by virtue of such collateral, a "secured creditor" within the meaning of the Bankruptcy Act. 11 U.S.C. § 1(28) (1976); 1 J. Moore, L. King, *et al.*, *Collier on Bankruptcy* ¶ 1.28, at 130.24 (14th ed. 1974).

[10] Thus, if a creditor had an allowed claim against the debtor that was secured both by a lien on the debtor's (*i.e.*, the estate's) property and by a lien on a third party's property, and if the "allowed secured claim" based on the debtor's (estate's) property were $39,000, then Section 506(d) would, read literally, void the lien on the third party's property, at least to the extent that the lien exceeded $39,000.

A. Petitioner's Property, Having Been Abandoned, Is Not "Property in Which the Estate Has an Interest."

1. Petitioner's attempt to apply Section 506 founders on the evident meaning of the phrase "property in which the estate has an interest." The phrase requires that the estate have, not merely some connection to, but a *property interest* in the collateral (*e.g.*, fee simple ownership, half-ownership, leasehold interest).[11] Any other interpretation would make nonsense of Section 506(a)'s use of the value of the "estate's interest" to refer to the collateral value (or, more precisely, the value of the estate's share of the collateral) to set the amount of the secured claim. 11 U.S.C. § 506(a) (quantifying the secured claim as "the value of [the] creditor's interest *in the estate's interest* in" the collateral (emphasis added)). This property interest of the estate, of course, is "property of the estate" under Section 541. 11 U.S.C. § 541(a).[12] Accordingly, "property in which the estate has an interest" must be "property of the estate" to the extent of the estate's interest in the property.

Abandoned property like petitioner's farmland, however, is to no extent property of the estate. H.R. Rep. No. 595, 95th Cong., 1st Sess. 343 (1977) ("[p]roperty ceases to be property of the estate . . . by . . . abandonment"); S. Rep. No. 989, 95th Cong., 2d Sess. 92 (1978) ("if property is neither abandoned nor administered it remains property of the estate"). It is well-recognized that "[a]bandonment is 'the release from the debtor's estate of property previously included in that estate.'" *Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection*, 474 U.S. 494, 508 (1986) (Rehnquist, J., dissenting) (quoting 2 W. Norton, *Bankruptcy Law and Practice* § 39.01 (1984)); 4 *Collier* ¶ 554.02, at 554-6 (15th ed.) ("[U]pon abandonment under section 554, . . . the property . . . is no longer part of the estate. Thus, abandonment constitutes a divestiture of all interests in property that were property of the estate."). An abandonment of the estate's property such as occurred here eliminates any property interest the estate has in the abandoned property and returns the property to its pre-bankruptcy status. *See Brown v. O'Keefe*, 300 U.S. 598, 602 (1937); Pet. App. 5a, 24a-26a (citing cases); H.R. Rep. No. 595, at 377; S. Rep. No. 989, at 92. Indeed, the trustee's notice of abandonment in this case made explicit the complete abandonment of *any* interest in the property: "the trustee hereby abandons any interest that the estate may have in and to said property." J.A. 24. The abandoned collateral here thus is not "property in which the estate has an interest."[13]

2. Apparently conceding that her position could not prevail if Section 506 used the phrase "property of the estate," petitioner suggests that the provision's use of the phrase "property in which the estate has an interest" compels a different result. Pet. Br. 26. She observes that, while early legislative versions of Section 506 used the phrase "property of the estate," the House Committee in

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[11] This is the natural use of the word "interest" in a bankruptcy context involving liens. Thus, in *Farrey v. Sanderfoot*, 59 U.S.L.W. 4483, 4484 (U.S. May 23, 1991), this Court read the phrase "interest of the debtor in property" in 11 U.S.C. § 522(f)(1) to refer to a "property interest."

[12] *Owen v. Owen*, 59 U.S.L.W. 4486, 4487 (U.S. May 23, 1991) ("An estate in bankruptcy consists of all the interests in property, legal and equitable, possessed by the debtor at the time of filing, as well as those interests recovered or recoverable through transfer and lien avoidance provisions.").

[13] Section 724(b) confirms this conclusion. That provision uses "property in which the estate has an interest" to refer to certain property that is to be "distributed." 11 U.S.C. § 724(b). The process of distribution, however, does not include abandoned property. *See, e.g.*, 11 U.S.C. § 725 (providing for disposition of property not "disposed of under another section"); S. Rep. No. 989, at 96 (abandonment provision, 11 U.S.C. § 554, is one such section).

1977 substituted the longer phrase that ultimately was enacted. Pet. Br. 26-27.[14] But petitioner does not and cannot point to any evidence in the legislative history suggesting that the alteration of the language was intended to produce what, in her view, was a significant change in the meaning of Section 506. *See American Hosp. Ass'n v. NLRB*, 111 S. Ct. 1539, 1544 (1991). And, in fact, there is a ready explanation for the substitution of phrases.

The enacted language takes explicit account of the common situation in which a creditor has a lien on a single piece of property that is not completely owned, in fee simple, by the debtor—a piece of land, for example, that is only half-owned by the debtor or in which the debtor has only a leasehold interest. In that circumstance, while the lien is on the land as a whole, only the debtor's interest in the property becomes property of the estate (11 U.S.C. § 541), and hence only that interest—the "estate's interest" in the property—serves to define the secured portion of the creditor's claim. For that situation, it was awkward and potentially confusing, though not perhaps technically inaccurate, for Section 506(a) to refer to the "lien on property of the estate" and to the value of the "property," since the lien was in fact on property that was not all property of the estate.

The language adopted by Congress more precisely and explicitly deals with this situation: it acknowledges the full range of property interests that the debtor, and hence the estate, could have in a piece of property securing a creditor's claim, even if less than the entirety of the collateral was "property of the estate." Section 506(a) thus refers to "a lien on property in which the estate has an interest" (the whole of the collateral) and declares that the claim is to be treated as secured only to the extent of the "estate's interest" in the property (that is, the debtor's interest in the collateral, now property of the estate). This change of language merely refined the earlier versions of Section 506: it made no substantive change in the scope of Section 506's coverage from what it would be if it used the term "property of the estate" —a phrase that, as petitioner seems to acknowledge, excludes abandoned property.[15]

[14] The House Committee's reported bill, H.R. 8200, § 506(a), 95th Cong., 1st Sess. (1977), substituted the ultimately enacted phrase for a provision of earlier bills that said: "An allowed claim of a creditor secured by a lien on property of the estate is a secured claim to the extent of the value of such creditor's interest in such property, and is an unsecured claim to the extent that such value is less than the amount of such allowed claim." H.R. 6 and H.R. 7330, § 506(a), 95th Cong., 1st Sess. (1977).

B. Petitioner's Proposed Impairment of Respondents' Property Rights in the Abandoned Collateral Would Not Serve the Basic Liquidation or Fresh Start Functions of Bankruptcy.

1. *The Code Disfavors Needless Impairment of State-Law Property Rights.*

Federal bankruptcy law has long embodied a commitment to respect state-law property entitlements, particularly the property rights of secured creditors, absent a clear expression of congressional intent to displace them. That commitment is evident in the Code's treatment of secured creditors generally, recognized recently by this Court: "Ordinarily, liens and other secured interests survive bankruptcy." *Farrey v. Sanderfoot*, 59 U.S.L.W. at

[15] That conclusion is supported by this Court's ruling on the significance of a comparable change made by Congress in Section 547(b) of the Code. In 1984, Congress changed the phrase "property of the debtor" in that provision to "an interest of the debtor in property." This Court, relying on the pertinent Senate Committee Report, recently made clear in *Begier v. IRS*, 110 S. Ct. 2258 (1990), that the two phrases are "coextensive." *Id.* at 2263 n.3. Not surprisingly, the very same Senate Committee Report also used the phrase "property of the debtor's estate" to refer to the "property in which the estate has an interest" that is covered by Section 506. S. Rep. No. 65, 98th Cong., 1st Sess. 5-6 (1983).

4484. Such interests are respected, to the fullest extent possible as *property* interests, through the guarantee of adequate protection (11 U.S.C. §§ 361-363): "what constitutes 'adequate protection' . . . is whatever gives the secured creditor the same value as the rights of repossession and sale would have given it." T. Jackson, *The Logic and Limits of Bankruptcy Law* 183 (1986).[16] As this Court explained in *Butner v. United States*, 440 U.S. 48, 56 (1979), "the federal bankruptcy court should take whatever steps are necessary to ensure that the [secured creditor] is afforded in federal bankruptcy court the same protection he would have under state law if no bankruptcy had ensued." [17]

The effect of voiding a lien like respondents' would be to strip them of some of their state-law property rights—their rights to foreclose on the property through judicial or nonjudicial forced sales. This Court has long recognized that such rights are property rights, protected by the takings clause of the Fifth Amendment. *See United*

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[16] A secured claim is "a claim to specific property, the creditor's collateral, rather than a claim to share in the distribution of the bankruptcy estate." R. Jordan & W. Warren, *supra*, at 211. Thus, secured creditors in a liquidation case are not placed in the distribution queue (11 U.S.C. §§ 507, 726), but are protected either through abandonment of the collateral and the lifting of the stay on foreclosure under Sections 554 and 362(d)(2), through the guarantee of adequate protection if the collateral is sold under Section 363, or through release of the collateral by the court under Section 725.

[17] The Court in *Butner* explained the general policy behind bankruptcy law's respect for state-law property rights, a policy that informs both the present Code and pre-Code law: "Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. Uniform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving a 'windfall merely by reason of the happenstance of bankruptcy.'" 440 U.S. at 54-55.

Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 370 (1988); *United States v. Security Indus. Bank*, 459 U.S. 70, 75 (1982). And the Court has indicated that disturbance of such rights, if nowhere mentioned in clear terms by Congress, is exceptional in bankruptcy law and not readily to be inferred. *See United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 244 (1989); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 581-86 (1935).

As explained below (*see* pages 29-32, *infra*), the legislative history of Section 506 indicates that Congress did *not* intend to displace respondents' state-law rights. Nor has petitioner pointed to anything in the operation of the Code that requires the lien reduction sought by petitioner. And as we now explain, lien reduction serves neither of the two basic functions of this chapter 7 case—to liquidate and distribute petitioner's assets, and to give petitioner a fresh start. *See* Pet. Br. 15 (chapter 7 allows debtors to "liquidate their assets, distribute the proceeds to creditors, and obtain a discharge of pre-filing debts").

2. *Abandoned Property Like Petitioner's Plays No Role in the Liquidation Proceeding and Is of No Benefit to the Estate.*

Because the collateral in this case has been completely abandoned, it will play no role in the fulfillment of "the paramount purpose of bankruptcy liquidation"—"the reduction of the debtor's property to money as expeditiously as practicable so as to secure funds for distribution to general creditors." *Collier* ¶ 554.01, at 554-2 to -3 (15th ed.). Not being property of the estate, it is not covered by the trustee's principal duty to "reduce to money the property of the estate" (11 U.S.C. § 704(1)), and it is not subject to the trustee's powers to sell, lease, or use "property of the estate" under Section 363. 11 U.S.C. § 363(b), (c). The property will not be administered in the proceeding. Pet. App. 6a ("Abandoned property is *not* property administered by the estate.").

Such property likewise plays no role in maximizing the estate (and hence any distribution to general creditors) or in equitably allocating petitioner's assets among general creditors. The very reason for the uncontested abandonment of the land as "of inconsequential value and benefit to the estate" (11 U.S.C. § 554(a)) was that the estate, and hence general creditors, could not have any stake in the land: because respondents' lien was so much greater in value than the collateral, respondents clearly would be entitled to the full value of the property under the guarantee of adequate protection of the lien (11 U.S.C. § 363(f)), leaving nothing for other creditors.[18] By the same token, application of Section 506 to render respondents' lien partly void could not benefit the estate or general creditors: once the collateral is no longer property of the estate, it is the debtor, under petitioner's view, who must receive the benefit of any recovery from the property in excess of the judicially determined value (otherwise, she has no stake in the present dispute). *See* 11 U.S.C. § 551 (preserving voided liens for the benefit of the estate "but only with respect to property of the estate"). In short, petitioner's property, once completely abandoned, is simply irrelevant to the bankruptcy proceeding's functions of liquidating and distributing petitioner's assets.

3. *The Fresh Start Policy Does Not Support Lien Reduction.*

As petitioner observes, one of the purposes of a chapter 7 liquidation is "to enable debtors 'to get out from under the debilitating effects of too much debt . . . [and] obtain

[18] Indeed, given that petitioner "does not have an equity in such property"—"*i.e.*, the creditor is undersecured" (*Timbers of Inwood Forest*, 484 U.S. at 375)—and that the property "is not necessary to an effective reorganization" in this liquidation case, respondents would be entitled to a lifting of the stay of foreclosure under 11 U.S.C. § 362(d)(2). In this case, lifting of the stay has been postponed pending resolution of the question whether Section 506 affects the amount of respondents' lien.

a fresh start.'" Pet. Br. 17 (quoting H.R. Rep. No. 595, at 125). But the fresh start policy is not a free-floating bankruptcy rule: it is, instead, a policy that informs particular provisions of the Code. It is therefore significant that the policy is nowhere mentioned in the legislative history supporting Section 506 (H.R. Rep. No. 595, at 357; S. Rep. No. 989, at 68), even though it *is* specifically mentioned in the legislative history supporting various other provisions of the Code, such as Sections 362 (automatic stay), 522 (exemption), 525 (discrimination against bankrupts), 722 (redemption), and 727 (discharge). *See* H.R. Rep. No. 595, at 125-28, 340, 366, 384; S. Rep. No. 989, at 54-55, 81, 98. The congressional omission of any reference to that policy in the present context has a simple explanation: the policy does not apply. None of the policy's functions supports petitioner's claim for partial voiding of respondents' lien.

One function of the policy is to give a debtor the breathing space provided by the automatic stay under Section 362, but that function is plainly a temporary one and cannot support the permanent relief petitioner claims. Another function of the fresh start policy is to provide "adequate property for a return to normal life." H.R. Rep. No. 595, at 125. But, for chapter 7 cases, the Code specifically addresses that concern in the carefully crafted provisions governing exempt property (§ 522) and redemption (§ 722). Those provisions are narrowly limited to individual (non-corporate) debtors and to specified types and amounts of property that Congress, either itself or through deference to state decisions, deemed especially necessary to a person's "normal life." 11 U.S.C. §§ 522, 722. By contrast, petitioner's view of Section 506 would apply to all debtors in liquidation, including corporate businesses, allowing them to reduce their liens on all types of property, including commercial real estate like petitioner's farmland. To read Section 506 as accomplishing that result is simply to override the careful

limits Congress placed on the fresh start policy in the present setting.[19]

The discharge provision of chapter 7, of course, embodies the particular function of the fresh start policy on which petitioner relies (Pet. Br. 17-18): to relieve the debtor from "the pressure and discouragement of preexisting debt." *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934), *quoted in Grogan v. Garner*, 111 S. Ct. 654, 659 (1991); *see Louisville Bank*, 295 U.S. at 582. But that purpose cannot justify lien reduction under Section 506(d) for the simple reason that the lien is a charge only against the property, not a claim against the debtor. The debtor is discharged from any personal liability on the preexisting debt regardless of the remaining amount of the lien. *E.g.*, 11 U.S.C. § 727(b). And Congress deliberately limited the effect of the discharge to precluding any "personal liability" of the debtor (11 U.S.C.

[19] Petitioner herself acknowledges that chapter 7 of the Code is not generally designed to protect the debtor's possessory interests in property (because liquidation is the process of selling the property to pay creditors), while the reorganization and rehabilitation chapters are designed generally to protect the debtor's continued possession. Pet. Br. 15-16 (in chapters 11 and 13, but not chapter 7, debtor is to retain assets); *see In re Lindsey*, 823 F.2d 189, 191 (7th Cir. 1987); D. Epstein, J. Landers, & S. Nickles, *Debtors and Creditors* 710-12 (3d ed. 1987). In the chapter 11 and 13 setting, this aspect of the fresh start policy likewise does not support petitioner's view of Section 506(d): abandonment should not occur if the debtor's possessory interest in property is to be protected by the plan of reorganization or rehabilitation.

Even aside from abandonment, protection of the possessory interest in chapter 11 and 13 cases does not *require* Section 506(d)'s broad application to reduce liens securing allowed claims, if only because other provisions of the Code permit liens to be modified as needed to protect the debtor's possessory interests as part of the confirmed plans of reorganization or rehabilitation. *See* 11 U.S.C. §§ 1123(a) (permitting modification of liens), 1141 (property under plan generally free of creditors' claims, except as provided by plan), 1322 (permitting modification of secured creditors' rights), 1327(c) (property under plan is free of creditors' claims, except as provided by plan).

§ 524(a)), expressly indicating that no preclusion of *in rem* judgments against property was intended by this aspect of the fresh start policy. *See Johnson v. Home State Bank*, No. 90-693 (June 10, 1991), slip op. 4-6; *Collier* ¶ 506.07, at 506-71 to -72 (15th ed.); *see also* S. Rep. No. 989, at 76 ("The bankruptcy discharge does not prevent enforcement of valid liens."); H.R. Rep. No. 595, at 361 (same). Thus, the fresh start policy's goal of leaving the debtor without overhanging personal liability cannot support petitioner's reading of Section 506(d). *See Louisville Bank*, 295 U.S. at 594 (contrasting fresh start and lien avoidance).

Petitioner's view of Section 506(d) plainly would give her, not a "*fresh* start," but a "*head* start." *Lines v. Frederick*, 400 U.S. 18, 21 (1970) (Harlan, J., dissenting). Collateral might well bring more at a foreclosure sale than the judicial valuation—either because of an error in the judicial valuation[20] or because of appreciation (or anticipated appreciation) in the property.[21] Petitioner's position is that she is entitled to be handed a check for the amount over the judicially determined value. But that result would be nothing more than the awarding of a windfall benefit, a judicial grant to the debtor of cash representing equity in the property that she never had while her secured creditor remains unpaid. The fresh start policy does not support such a result.

[20] *See Collier* ¶ 506.04, at 506-26 (15th ed.) (because of "the inherent difficulty of determining the price that would be obtained in a hypothetical sale or other disposition of many, if not most, kinds of property that is not of a truly fungible nature, valuation should not be viewed as an exact science by any means"); S. Rep. No. 65, at 5-6 ("the courts have, in too many cases, undervalued collateral property to an extent which denies adequate protection to secured creditors").

[21] If the date of the bankruptcy petition is used as the valuation date (*see* note 32, *infra*), and the proceeding is lengthy, market fluctuations and other factors may substantially increase the value of the collateral prior to foreclosure.

C. Petitioner's Proposed Lien Reduction Under Section 506 Would Be Inconsistent with Section 722's Specific Limits on Redemption Rights.

Petitioner's reading of Section 506 would be "structurally inconsistent" (*Timbers of Inwood Forest*, 484 U.S. at 374) with Section 722: under her reading, petitioner "in effect achieves the same result" (*ibid.*) that Congress denied her in Section 722. Section 722 gives an "individual debtor" in a liquidation proceeding a right to

> redeem tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt, if such property is exempted under section 522 of this title or has been abandoned under section 554 of this title, by paying the holder of such lien the amount of the allowed secured claim of such holder that is secured by such lien.

The provision, which marked "a very substantial change" from previous bankruptcy law (S. Rep. No. 989, at 95), is unusual in that it specifically addresses the rights of a debtor vis-a-vis a creditor with an allowed claim secured by a lien on property that is, because of exemption or abandonment, no longer of any interest to the estate or general creditors. The provision thus deals with precisely the same situation that is at issue in the present dispute over Section 506(d).

Section 722 is limited by its terms in a number of ways —to *individual* debtors with *consumer* debts secured by *tangible, personal* property intended for specific (*personal, family,* or *household*) uses. It is limited in those ways because Congress identified a problem peculiar to the specified circumstances: the covered consumer goods, once used, typically have an (ever-diminishing) market value much lower than their replacement value, so debtors are placed under great pressure by lienholders to enter into agreements reaffirming their full debts under 11 U.S.C. § 524(c) and (d); yet such agreements would give

the creditors an undue benefit over and above what they could receive upon repossession or foreclosure using the ordinary state-law processes. H.R. Rep. No. 595, at 380-81. Not seeing a comparable problem for other types of property, Congress restricted the right to redeem to the specified property, thus excluding real property like petitioner's.

Petitioner's view of Section 506 would both render Section 722 unnecessary for the consumer goods it does cover and effectively give any debtor, including those excluded from Section 722, a right to redeem any property, including property excluded from Section 722. Petitioner herself recognized the equivalence of lien reduction and redemption in the courts below. *See* note 5, *supra*. The reason is straightforward: if a lien on property is void over the judicially determined value (the amount of the "allowed secured claim"), any debtor who had the money to purchase the property for that amount under Section 722 could readily achieve the same result through the exercise of ordinary state-law rights.

Most readily, any debtor will be able to exercise the state-law right—apparently available in every jurisdiction—to buy any property, prior to any foreclosure, for the amount of the obligation that is secured by the collateral, now reduced by Section 506 to the "redemption" price.[22] Moreover, even if a foreclosure sale were to be

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[22] If Section 506(d) applies as petitioner suggests, "the debtor can redeem the property from secured creditors prior to foreclosure by paying an amount equal to the court's assessment of the collateral's value." Note, *An Individual Debtor's Right to Avoid Liens Under Section 506(d) of the Bankruptcy Code*, 12 Cardozo L. Rev. 263, 265 (1990); *id.* at 265 n.11 ("if a debtor owning overencumbered real or personal property defaults on a loan, uses section 506(d) to freeze the amount of the liens, and tenders payment of this reduced debt in full prior to foreclosure, then the secured creditor is required to accept payment and restore free and clear title to the debtor"); G. Osborne, G. Nelson, & D. Whitman, *Real Estate Finance Law* § 7.1 (1979) (preforeclosure "redemption" right available "in every juris-

held, a debtor who had the money to redeem the collateral could, as a practical matter, purchase the property at an immediate foreclosure sale: she could outbid any other bidder, without cost to herself, because any amount over the reduced lien value (excepting sale costs) is returned to her as the "owner" (trust grantor, mortgagor). *See, e.g.*, Utah Code Ann. § 57-1-29.[23] In either event, a debtor who was capable of exercising a Section 722 right could, by application of Section 506(d) alone, exercise the ordinarily available rights under state law and readily purchase the property just as if Section 722 applied.

If Section 506(d) reduced all debtors' liens on all property, therefore, there would have been no need for Section 722: the consumer-goods creditor would already have been stripped of the leverage to demand reaffirmation of the full lien. By the same token, if Congress had wished to enable debtors (including corporations) to purchase property other than that specified in Section 722 (including real property like petitioner's) for the amount of the "allowed secured claim," it surely would have so provided in Section 722, where it explicitly took the unusual step of adjusting rights solely between debtors and lienholders. Petitioner's view of Section 506 should be rejected because it would override the narrow limits on the special rights granted in Section 722.

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diction"); *id.* §§ 7.1-7.5 (discussing real property redemption law); U.C.C. § 9-506 (personal property redemption law).

[23] Thus, if the lien in this case were reduced to $39,000, and the sale were held immediately thereafter, petitioner could bid *any* amount over that sum—*e.g.*, if another bidder offered $60,000, she could bid $100,000—and still have a net cost of only $39,000 (plus sale costs): everything over that amount would be paid back to her. Even the sale costs should become insignificant once the debtor makes clear her intention and ability to pay the "redemption" price. In that situation, there should be few if any sale costs, both because no transfer of title to a new purchaser is required and because it will typically be pointless to hold a trustee's sale at all.

D. Applying Section 506 Here Would Be Counter to Pre-Code Bankruptcy Law and to the Legislative History.

In determining the intended meaning of Bankruptcy Code provisions, this Court has examined the state of pre-Code law for "interpretive assistance." *Ron Pair Enters.*, 489 U.S. at 244-45. The Court has explained that it "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure," especially where a change would produce an alteration of long-respected state-law property rights. *Pennsylvania Dep't of Public Welfare v. Davenport*, 110 S. Ct. 2126, 2133 (1990); *Ron Pair Enters.*, 489 U.S. at 244-45; *Midlantic Nat'l Bank*, 474 U.S. at 500-02; *Kelly v. Robinson*, 479 U.S. 36, 47-49 (1986). *See also Timbers of Inwood Forest*, 484 U.S. at 380; *Emil v. Hanley*, 318 U.S. 515, 521 (1943). That principle applies here. Pre-Code bankruptcy law did not reduce a secured creditor's lien on property that was not administered in the bankruptcy proceeding. Yet the language of Section 506 of the new Code does not command a different result (as discussed above), and there is no evidence in the legislative history to alter the pre-Code rule. Indeed, the legislative history strongly suggests that Congress intended to preserve the pre-Code practice—as this Court recently stated in *Johnson v. Home State Bank*, slip op. 4.

1. *Pre-Code Bankruptcy Law Preserved Liens Like Respondents'.*

Section 57(h) of the Bankruptcy Act of 1898, as amended (11 U.S.C. § 93(h) (1976)), "recognized the right of a secured creditor to pay itself from its security, and provided a means whereby and described the extent to which the secured creditor, if it chose to do so, could participate in distributions from the estate." *Collier* ¶ 506.02, at 506-3 (15th ed.). Thus, Section 57(h) permitted a secured creditor to participate in the distribu-

tion of the estate, but only after conversion into money or valuation of the collateral and "only on the unpaid balance." 11 U.S.C. § 93(h) (1976); *see Collier* ¶ 506.02, at 506-4 (15th ed). This so-called "bankruptcy rule" replaced the "equity rule," under which such a creditor could participate to the full extent of his claim. *See United States Nat'l Bank in Johnstown v. Chase Nat'l Bank*, 331 U.S. 28, 33-34 (1947); *American Sur. Co. v. Bethlehem Nat'l Bank*, 314 U.S. 314, 320 n.2 (1941) (Douglas, J., dissenting) (describing history of bankruptcy rule); *Merrill v. National Bank of Jacksonville*, 173 U.S. 131 (1899); *see* 11 U.S.C. § 597 (1976) (bankruptcy rule for reorganizations).

While limiting participation in the distribution from the estate, pre-1978 bankruptcy law did not reduce the secured creditor's *in rem* rights in the property: the statute said nothing to impair the validity or amount of the lien. "The 1898 Act contained no express provisions relating to . . . the effect of the bankruptcy case on the lien of a secured creditor." *Collier* ¶ 506.02, at 506-5 (15th ed.). And the clear practice under the Act was therefore to leave the lien itself unaffected. Derived from *Long v. Bullard*, 117 U.S. 617 (1886), the rule was summarized by this Court in *Louisville Bank*: "unless the mortgagee released his security, in order to prove in bankruptcy for the full amount of the debt, a mortgage even of exempt property was not disturbed by bankruptcy proceedings." 295 U.S. at 582-83 (citing *Long v. Bullard*). *See In re O'Gara Coal Co.*, 12 F.2d 426, 429 (7th Cir.), *cert. denied*, 271 U.S. 683 (1926) ("The provision and purpose of the law is that those having security shall, in the manner provided by the statute, get the benefit of that security, but must do so at the expense of reducing the claim upon which they are entitled to participate as a general creditor in the funds of the estate.").[24]

[24] This Court recently recognized the point even for exempt (that is, specially protected) property: "it was well settled . . . [in 1978] that valid liens obtained before bankruptcy could be enforced on

Accordingly, the judicially assigned value of collateral for an allowed claim under pre-Code law applicable to liquidations did *not* set a limit on the creditor's interest in the property itself, but left his full lien intact.[25] The effect of lien preservation was particularly significant where, as in the present case, the collateral was released from control of the bankruptcy court through abandonment, and foreclosure proceedings were pursued outside bankruptcy as permitted by state law: the creditor could collect up to the amount of the lien, as long as the underlying claim was not satisfied more than once and the creditor had not previously released the lien in order to claim a distribution from the estate as an unsecured creditor to the full extent of its claim. *See* 3 J. Moore, L. King, *et al.*, *Collier on Bankruptcy* ¶ 57.20, at 358-59 (14th ed. 1977). Pre-Code bankruptcy law thus recognized the special protection that creditors like respondents obtain by perfecting a security interest in property, and it treated the resulting charge against property as distinct from the personal claims against the debtor, leaving the *in rem* claims essentially undisturbed while discharging the debtor from the *in personam* claims.

2. *The Legislative History Shows that Congress Did Not Intend to Alter the Pre-Code Practice.*

Nothing in the legislative history refers to, or indicates that Congress intended to alter, the pre-Code preservation of liens like respondents'. Nor is there any indication that Congress intended to grant debtors like petitioner the benefit she claims—a limitation on the lien-

exempt property, see *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 582-583 (1935), including otherwise exempt homestead property, *Long v. Bullard*, 117 U.S. 617, 620-621 (1886)." *Farrey v. Sanderfoot*, 59 U.S.L.W. at 4484.

[25] Like the present Code (*e.g.*, 11 U.S.C. § 1123(a)(5)(E)), chapter X of the Bankruptcy Act separately *permitted* liens to be judicially modified, with appropriate protection of the lienholders' rights, by a plan of reorganization. 11 U.S.C. § 616(10) (1976).

holders' interest in the collateral to the judicially assigned value, thereby enabling the debtor to reap the benefit of any amount recovered at a foreclosure sale in excess of that amount, even if the lienholders have not been paid the debt that was secured by the property.[26] Such an absence of congressional statements supporting petitioner's reading of Section 506 is strong evidence that Congress did not intend the dramatic departure from longstanding prior law that petitioner claims.

The absence of legislative history supporting petitioner's claim to the benefit of lien reduction is particularly telling because Congress *did* specifically mention *other* benefits provided to debtors by Section 506. In describing the "new treatment of secured claims, especially the bifurcation of the claims into secured and unsecured claims," the House Committee observed that this treatment "has important protective consequences for both creditors and the debtor." H.R. Rep. No. 595, at 181. After describing the benefit to creditors (protection of the collateral value), the Committee stated: "For the debtor, the determination of the amount of the secured claim facilitates reorganization in the business context, and repayment plans in the consumer context, by defining the precise extent of the claims against the debtor that must be treated specially as secured claims." *Ibid.* (footnote, citing proposed §§ 1124, 1129, 1325(a)(5), omitted). The identified benefits to debtors are, first, focused only on Section 506(a) and, second, limited to cases under chapters 11 and 13. If Congress had intended that 506(d) would allow liquidating debtors to strip down a lien ad retain any proceeds over the judicially assigned value, that quite striking benefit would have been mentioned. *See also Collier* ¶ 506.01, at 506-2 to -3 (15th ed.) (discussion of other benefits, but not the benefit claimed by petitioner).

[26] As noted in Section II below, the only pertinent statements in the legislative history directly addressed to Section 506(d) strongly suggest that the provision voids a lien only to the extent that a claim has not been allowed. *See* page 43, *infra*.

In fact, the legislative history expressly undercuts petitioner's reading of Section 506(d): Committee statements describing 11 U.S.C. § 522, which governs exempt property, show that Congress affirmatively intended liens like respondents' to survive, as pre-Code law provided. *See Johnson v. Home State Bank*, slip op. 4 ("Codifying the rule of *Long v. Bullard*, 117 U.S. 617 (1886), the Code provides that a creditor's right to foreclose on the mortgage survives or passes through the bankruptcy."). Section 522(c) gives meaning to the "exempt" character of property by generally declaring that exempt property is not liable for any pre-petition debts of the debtor (including, of course, debts supporting allowed claims). 11 U.S.C. § 522(c). The provision then states exceptions, among them that such property *is* liable for debts secured by liens that are "not void under Section 506(d)" (if the liens are also not avoided under other provisions, such as Section 522(f)). 11 U.S.C. § 522(c). In explaining the provision, the House Committee Report states: "The bankruptcy discharge will not prevent enforcement of valid liens. The rule of *Long v. Bullard*, 117 U.S. 617 (1886), is accepted with respect to the enforcement of valid liens on nonexempt property as well as on exempt property. *Cf. Louisville Joint Stock Land Bank* v. *Radford*, 295 U.S. 555, 583 (1935)." H.R. Rep. No. 595, at 361 (footnote omitted). *See* S. Rep. No. 989, at 76 (identical language except for use of "does" in place of "will" in first sentence). That rule, as the cited page of *Louisville Bank* says, was that "unless the mortgagee released his security, in order to prove in bankruptcy for the full amount of the debt, a mortgage even of exempt property was not disturbed by bankruptcy proceedings." 295 U.S. at 582-83 (citing *Long v. Bullard*). Congress thus evinced its intent that Section 506(d) left in place the pre-Code practice of preserving liens.

That understanding clearly favors reading Section 506(d) to continue pre-Code practice, particularly as to abandoned property. For one thing, abandoned property is exactly like exempt property in that both are property

in which the estate no longer has, but once had, an interest: if that was the basis for the congressional understanding of Section 506(d)'s inapplicability to exempt property, the same understanding carries over to abandoned property. In fact, however, the congressional understanding extends more broadly—not only by virtue of the Committee Reports' reference to "nonexempt property as well as . . . exempt property," but also by necessary implication. If Congress intended to preserve liens on the special types of property that it singled out for exemption because of their importance to the debtor, it could not have intended Section 506(d) to void liens on other property, like commercial farmland, that is less personally important or necessary to the debtor.

E. Other Aspects of the Bankruptcy Code Undermine Petitioner's Claimed Entitlement to the Benefit of Lien Reduction in This Liquidation Case.

Petitioner's reading of Section 506(d) is further undermined by at least two additional aspects of the Bankruptcy Code—Section 551's preservation of voided liens for the benefit of the estate, not the debtor; and the congressional preference for reorganizations over liquidations.

1. *Section 551 Denies the Benefit of a Voided Lien to the Debtor.*

Section 551 of the Code undermines petitioner's reading of Section 506(d) as a matter of both congressional policy and statutory operation. Secton 551 declares, for property of the estate, that an avoided or stripped-down lien is preserved for the benefit of the estate. 11 U.S.C. § 551. The section thus operates to give to the general creditors, not the debtor, any recovery from such property at a foreclosure sale over the judicially determined amount but up to the lien value. Petitioner's view, by contrast, would give to the debtor—not to the general

creditors, and not to the secured creditor who has not been repaid—the benefit of the lien to the extent that it has been reduced. Yet if Congress in Section 551 clearly denied the debtor the benefit of a voided lien in preference to unpaid general creditors, Section 506(d) should not be read to grant debtors the same preference over unpaid secured creditors.

Indeed, the operation of Section 551 together with the abandonment provision, 11 U.S.C. § 554, leads directly to the court of appeals' reading of Section 506 as not voiding a lien on abandoned property. If the trustee has not abandoned the overencumbered collateral, then the portion of the lien voided by Section 506(d) is itself a property interest of the estate in the collateral under Section 551. When *that* interest is abandoned by the trustee, it revests in its prior owners, the secured creditors—just as the underlying collateral, upon abandonment, revests in its prior owner, the debtor. *See* Note, 12 Cardozo L. Rev. at 281 n.108 (citing H.R. Rep. No. 595, at 377; S. Rep. No. 989, at 92; *Brown v. O'Keefe*, 300 U.S. at 602-03). In two steps, then, the lienholders are returned to possession of their full lien. The same result should follow if the complete abandonment is accomplished in a single step—as here, by the trustee's abandonment of "any interest that the estate may have in and to said property." J.A. 24. In this situation, too, the lienholders should retain their full lien. *See* Note, 12 Cardozo L. Rev. at 282-83.

2. *Petitioner's Reading of Section 506(d) Would Undermine the Congressional Preference for Reorganization.*

Petitioner acknowledges that "Congress has expressed a preference for reorganization" over liquidation. Pet. Br. 20 n.11; *see, e.g.*, 11 U.S.C. § 706; *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204 (1983). Yet her view of Section 506(d) would give debtors an incentive—in some cases, a very large incentive—to choose chapter 7 over chapter 11. That result would be especially

anamolous in light of Congress's reference to the benefits secured by Section 506 to chapter 11 debtors without mention of petitioner's claimed benefit for chapter 7 debtors. *See* page 30, *supra*.

In chapter 11, Congress gave creditors the right, even when collateral was not abandoned, to insist on full preservation of their liens on collateral, thus denying any stripping down under Section 506. 11 U.S.C. § 1111(b). Congress gave those rights to the chapter 11 creditor specifically so that the creditor, rather than the debtor, would benefit if the judicial valuation turned out to be too low or if the property appreciated in value in the future (the creditor could buy it at the foreclosure and resell it when the market rose). *In re Woodbridge N. Apts., Ltd.*, 71 Bankr. 189 (Bankr. N.D. Cal. 1987). Under petitioner's view of Section 506, however, debtors under chapter 7 would automatically gain that benefit by having their liens stripped down, thus giving debtors one incentive to choose liquidation over reorganization. In some cases, where the sole or major asset is a single piece of encumbered property that has taken a substantial fall in market value but is expected to rise in value as the market recovers, the incentive could be determinative of the choice between chapter 7 and chapter 11. Indeed, petitioner's view of Section 506 could provide a sufficient incentive for the debtor to file for bankruptcy in the first place, since a chapter 7 filing would enable the debtor to reduce her mortgage to the temporarily low market value.[27]

[27] For example, if farm property mortgaged for more than $100,000 and valued at that amount at the time of the mortgage later dropped in value to $40,000 (because, *e.g.*, of floods), a chapter 7 filing would, under petitioner's theory, allow the debtor to reduce the mortgage to $40,000, while a chapter 11 filing would not. That is essentially what occurred in this case. Indeed, petitioner in this case twice filed chapter 11 petitions that were dismissed after she was unable to propose a plan of reorganization; only then did she resort to chapter 7 in an attempt to strip down respondents' lien. *See* page 3, *supra*.

It is not responsive to say, as petitioner does (Pet. Br. 21-23), that Section 1111(b)(2) is an express exception to Section 506(d). The point is not that Section 506 contains any exception for chapter 7 cases but that, in determining the proper meaning of Section 506, the Court should consider whether the *result* produced by a proposed interpretation would undermine the congressional policy favoring reorganization. Petitioner's reading of Section 506 would undermine that policy.[28]

F. Section 506(a) Fixes the Portions of a Claim to Be Treated As Secured and Unsecured for Distribution Purposes Even Where the Collateral Is Eventually Abandoned and Is Therefore Outside Section 506(d).

Aside from the mistaken argument based on the fresh start policy, petitioner's principal argument against the court of appeals' reading is that Section 722's use of the phrase "allowed secured claim" in discussing "abandoned" property implies that such property is covered by Section 506(d). Pet. Br. 16 n.8, 26-27.[29] The argument is

[28] An analogous point might be made with respect to rehabilitation under chapter 13. The argument would depend, however, on the proposition that Section 1322(b)(2) overrides the otherwise-clear application of Section 506(d) to home mortgages. As petitioner notes, three courts of appeals have rejected that proposition, although the bankruptcy courts are divided on the issue. *See* Pet. Br. 19-20 & n.10. The issue need not be resolved in this case.

[29] Petitioner also suggests that the court of appeals' reading of Section 506(d) would render it superfluous (Pet. Br. 28), but that is not so. Under the court of appeals' reading, the provision is applicable where overencumbered (non-exempt) collateral has not been abandoned. That may well occur even in some chapter 7 cases: for example, if collateral (*e.g.*, supermarket equipment) must remain as an essential part of unencumbered property (the supermarket building) in order to maximize the return to the estate from the sale of assets (to obtain the value of a functioning supermarket), the trustee should not abandon the collateral because it is not "of inconsequential value and benefit to the estate." 11 U.S.C. § 554(a). Section 506(d) will also apply in many, probably most, cases under chapters 11 and 13. As petitioner has noted, reorganization and

not that Section 722 refers to or requires the voiding of any lien under Section 506(d): Section 722 by itself "redeem[s]" the property "from [the] lien" without need for Section 506(d). 11 U.S.C. § 722; *see also Black's Law Dictionary* 1442 (4th ed. Rev. 1968) (to "redeem" is to "buy back" and to "liberate an estate or article from mortgage or pledge by paying the debt for which it stood as security"; it "implies the existence of a debt and means to rid property of that incumbrance"). Petitioner's argument, instead, is that the reference to "allowed secured claim" as setting the redemption price of abandoned property shows that Section 506(a) is applicable to such property and therefore that Section 506(d) is applicable.[30]

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rehabilitation proceedings are designed largely to protect the debtor's continued possession of property that is necessary for post-bankruptcy success. Pet. Br. 15-16. Such property should not be abandoned by the trustee as being "of inconsequential value and benefit to the estate." 11 U.S.C. § 554(a).

[30] As a technical matter, Section 722's reference to Section 506(a) is explicable based on the unique nature of property covered by Section 722. The contingent redemption right granted by Section 722 would seem itself to be a property interest of the debtor that is property of the estate under Section 541 and remains so after the underlying collateral has been abandoned. If the debtor has asserted her intention to exercise her redemption right for certain consumer goods—she must do so within 30 days of filing her petition and then exercise the right within an additional 45 days, 11 U.S.C. § 521(2)—then abandonment by the trustee of the goods themselves should not include, or be construed as including, an abandonment of that redemption interest, a property interest, in the collateral. (The right to redeem the collateral immediately has a value equal to the value of the collateral.) Where, as here, Section 722 does not apply, however, there is no basis for avoiding the conclusion that the collateral has been completely abandoned, as the trustee said in his notice of abandonment (J.A. 24), and is therefore no longer property in which the estate has an interest.

We address in text the broader question of Section 506(a)'s setting of the secured and unsecured portions of a claim secured by collateral that is no longer "property in which the estate has an interest."

It is at this last step where petitioner goes wrong. Section 506 is *not* all of a piece: the fact that subsection (a) divides a claim into secured and unsecured portions where the collateral is abandoned does not imply that subsection (d) applies to such property. Rather, the statute is properly read so that subsection (a) continues to furnish the bifurcation of a secured claim into secured and unsecured amounts for distribution (and redemption) purposes, even while subsection (d) is inapplicable in adjusting the specific property rights of debtors vis-a-vis lienholders in collateral that is of no interest to the estate.

Subsections (a) and (d) apply differently because they address different problems. Subsection (a) is designed simply to assign a monetary value of the estate's obligations to creditors for distribution purposes. *See, e.g.*, 11 U.S.C. §§ 507, 726, 1129, 1325.[31] The eventual status of collateral outside bankruptcy is of no importance to the fixing of the amounts of the secured and unsecured obligations. For collateral that is eventually abandoned, therefore, Section 506(a) should be read as permanently fixing, while the collateral is property of the estate, the portions of the secured claim that will be treated as secured and unsecured.

This approach is authorized by Section 506(a)'s second sentence, directing that collateral be valued "in light of the purpose of the valuation and of the proposed disposition or use of such property." The distribution purpose of Section 506(a), as just explained, calls for a fixed pre-

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[31] Other provisions, such as 11 U.S.C. § 1129(b)(2), may alter the amount of distribution obligations for particular purposes or call for valuations independently of Section 506(a). As to the latter, for example, the guarantee of "adequate protection" of secured creditors does not and could not depend on Section 506(a). The pertinent Code provisions make no reference to Section 506(a) or to "allowed secured claims." 11 U.S.C. §§ 361-363. Those provisions must apply even when Section 506(a) is inapplicable because no proof of claim has been filed.

abandonment value. Indeed, if the valuation had to be kept up to date even after abandonment, a bankruptcy court would, in lengthy reorganization cases, be required to revalue collateral long after it had been abandoned. Such a requirement would hardly comport with abandonment's core function of ridding the bankruptcy proceeding of the duty to deal with the property.[32]

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[32] The Court need not decide whether the collateral value should be fixed for Section 506(a) purposes, either categorically or case by case, as of the date of the bankruptcy petition or as of some other pre-abandonment date. On the one hand, Section 502(b) fixes the amount of the allowed *claim* "as of the date of the filing of the petition" (11 U.S.C. § 502(b)), and *Timbers of Inwood Forest*, 484 U.S. at 372, suggests that the value of the collateral is fixed for Section 506(a) purposes from the petition date. Other provisions of the Code likewise treat the petition date as the "line of cleavage." *Everett v. Judson*, 228 U.S. 474, 479 (1913). *See, e.g.*, 11 U.S.C. §§ 522(a)(2), 522(b), 727(b). Pre-Code bankruptcy law treated the petition date as critical. *See In re O'Gara Coal Co.*, 12 F.2d at 430 (collateral value fixed as of time of petition). Moreover, a number of bankruptcy courts, including some that have supported petitioner's reading of Section 506(d), have used the petition date. *See, e.g., In re Donohue*, 110 Bankr. 41, 44 (Bankr. D. Kan. 1990); *In re Lindsey*, 64 Bankr. 19, 24 (Bankr. C.D. Ill. 1986); *In re Tanner*, 14 Bankr. 933 (Bankr. W.D. Pa. 1981); *see also In re Stoller's*, 93 Bankr. 628, 635 (Bankr. N.D. Ind. 1988) (value of collateral for purposes of 506(b)).

On the other hand, the Senate Committee Report and post-conference legislative statement, as well as the leading treatise, indicate that the valuation of collateral may change during the bankruptcy proceeding—although the cited examples involve valuations for purposes of different provisions (and only while property remains the estate's), not differing valuations for Section 506(a) purposes at different times (much less for abandoned property). S. Rep. No. 989, at 68; 124 Cong. Rec. S17411 (daily ed. Oct. 6, 1978); *Collier* ¶ 506.04, at 506-22 to -25, 506-37 to -39 (15th ed.). *Timbers of Inwood Forest* indicates that other Code provisions might use a different value from that set under Section 506(a): having suggested that the value of collateral is fixed under Section 506(a) standing alone (484 U.S. at 372), the Court said that the language of Section 1129(b)(2) gave secured creditors in chapter 11 the value of (non-abandoned) collateral as of the date of the reorganization plan. 484 U.S. at 377.

The proper valuation date should take into account any Code policies, which may differ from context to context, governing who should get the benefit of collateral's appreciation or bear the burden of depreciation. For example, Section 361 offers creditors adequate protection against depreciation from the petition date. *See Timbers of Inwood Forest*, 484 U.S. at 370. Section 551's preservation of voided liens for the estate might suggest that the estate should benefit from any appreciation in collateral value for non-abandoned property, while Section 552's specific protection of liens covering proceeds of collateral might suggest that the lienholder should benefit. At least one commentator has noted that the bankruptcy courts have used the petition date for valuation in cases that involve appreciating property. Carlson, *Undersecured Claims Under Bankruptcy Code Sections 506(a) and 1111(b): Second Looks at Judicial Valuations of Collateral*, 6 Bankr. Dev. J. 253, 254 n.2 (1989).

In contrast to subsection (a) of Section 506, subsection (d) is not concerned with the distribution process. It is addressed to the scope of a lienholder's continuing state-law property rights in the collateral itself. In this context, it is inappropriate to ask simply whether the collateral was *ever* property of the estate. Rather, a continuing interest of the estate in the collateral must exist in order to limit the lienholder's interests under Section 506(d). If, in order to protect the debtor's eventual possessory interest vis-a-vis the lienholder, the trustee has not abandoned the collateral—that is, the estate has retained its interest in the collateral—then Section 506(d) applies. If, on the other hand, the collateral has been abandoned because there is no continuing possessory interest of the debtor to protect against the lienholder's charges on the property, the collateral is not property in which the estate has an interest and is outside Section 506(d). The lienholder's property rights are thereby respected where, as in this case, no legitimate bankruptcy purpose would be served by disturbing them—even while Section 506(a) continues to serve its function in the distribution process.

II. Section 506(d) Does Not Apply to Respondents' Lien Because Their Claim Has Been Fully Allowed.

In addition to the fact that respondents' lien is not on the estate's property, there is a second reason—focusing not on the nature of the collateral, but on the nature of the claim—why Section 506(d) should be held not to apply to respondents' lien. Thus, Section 506(d) can, and should, be read as voiding a lien only to the extent that the claim it secures has not been allowed. Under this interpretation, while Section 506(a) bifurcates an allowed claim into secured and unsecured parts, Section 506(d) is not a bifurcating, or lien-*reducing*, provision at all for those claims, like respondents', that have been fully allowed.[33]

The language of Section 506(d) readily permits this reading. In the phrase "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim," the final three words need not be read, as petitioner reads them, as an indivisible term of art defined by Section 506(a). Subsection (a), in fact, is not by its terms a definitional provision; it merely sets the amounts of certain claims for distribution purposes and does not even use the three-word phrase "allowed secured claim." 11 U.S.C. § 506(a). Although that phrase, like "allowed unsecured claim," is used elsewhere in the distribution and plan-confirmation provisions of the Code to refer back to the amount that is established by Section 506(a) (*see, e.g.*, 11 U.S.C. §§ 507, 726, 1129, 1325), the three words in Section 506(d) simply need not be read to refer to that amount. Rather, the phrase can be read, term by term, to refer to any claim that is allowed and that is secured. Under this reading, Section 506(d) applies only to a lien that secures a claim—by definition, a

[33] The United States fully elaborates on this interpretation in its Brief as *Amicus Curiae*.

"secured" claim—that has not been allowed ("that is not an allowed secured claim").[34]

Section 506(d)'s use of the phrase "[t]o the extent that" reflects nothing more than the fact that a claim may be allowed only in part. Thus, Section 502(b) both expressly directs the bankruptcy court to determine the amount of a claim—including the "allowed claim . . . secured by a lien" (11 U.S.C. § 506(a))—and declares that the claim shall not be allowed "to the extent that" it falls into defined categories. 11 U.S.C. § 502(b). Section 506(d), then, declares that a lien is void to the extent that the claim has not been allowed. Of course, if the claim secured by the lien has been fully allowed, as in this case, then no part of the lien is void.[35]

This reading of Section 506(d) finds support, as an initial matter, in the exceptions to Section 506(d). The exceptions declare that certain liens are not void despite the fact that the claims they secure have been "disallowed" under certain subsections of Section 502 or have not been allowed for the simple reason that no proof of claim was filed. 11 U.S.C. § 506(d)(1) and (2). The exceptions thus underscore that the emphasis in Section 506(d) is on whether the claim has been allowed, rather than on what portion of the claim is treated as secured

[34] If the lien secures a claim, then the claim is by definition a secured claim. 11 U.S.C. § 101(37) (defining "lien" as a "charge against or interest in property to *secure* payment of a debt or performance of an obligation") (emphasis added). The term "secured" is nowhere defined in the Code.

[35] The placement of this lien-voidance provision as subsection (d) of Section 506 does not imply that it must follow the bifurcating role of Section 506(a). The provision naturally belongs in Section 506 because that is the section in which Congress addressed the relationship between allowed claims and secured status. The preservation of liens is but one aspect of that relationship. The proper treatment of a secured claim for distribution purposes is another, distinct aspect.

for distribution purposes. The second exception is particularly supportive. There is no good reason why Congress, having preserved a lien held by a creditor who successfully ignored the bankruptcy proceeding (as paragraph (d)(2) provides), should be understood to have stripped away property rights of a creditor who took the step of participating actively in the proceeding.[36]

This reading of Section 506(d) gives the provision the simple and sensible function (subject to the two stated exceptions) of voiding a lien whenever the claim secured by the lien has itself not been allowed. It thus ensures that the Bankruptcy Code's determination not to allow the underlying claim is given full effect by preventing assertion of a disallowed claim against the debtor's property as well as against the debtor personally. This is particularly significant where a portion of an otherwise-valid claim has been disallowed under Section 502(b) because of the type of claim it is; that is, where the claim is valid under state law (*e.g.*, a valid debt) but is not to be allowed in bankruptcy because, for example, it is a claim for unmatured interest or for certain property tax assessments or for unmatured alimony. *See* 11 U.S.C. § 502(b)(2), (4), (6).[37]

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[36] Section 501(c) permits a debtor or trustee to file a proof of claim on a creditor's behalf (11 U.S.C. § 501(c)), but the expressed purpose of that provision was not to give a lien-stripping right to the debtor. Rather, the aim of the provision, which is addressed to debts that are not dischargeable, was simply to reduce the debtor's post-bankruptcy debt by enabling the debtor or trustee to insist that such a non-dischargeable debt be partly paid through the bankruptcy distribution. S. Rep. No. 989, at 61.

[37] If the claim is disallowed because it is simply invalid on ordinary state-law grounds—*i.e.*, the debtor is not indebted or obliged to the claimant as alleged—then the lien itself would, to that extent, seemingly be invalid as well. *See* 11 U.S.C. § 101(37) ("lien" secures "payment of a debt or performance of an obligation"). In that circumstance, the lien would evidently be invalidated by the disallowance of the claim without need for Section 506(d). Of course, Section 506(d) makes that result explicit.

This interpretation not only comports with the statutory language, but is strongly supported by the legislative history. This reading preserves pre-Code bankruptcy law's rule permitting liens to pass through bankruptcy, a rule that the legislative history, far from suggesting any congressional intent to alter, affirmatively endorses. *See* pages 27-32, *supra*. Moreover, the particular legislative history of Section 506(d) strongly suggests the present reading of the provision. Both the Senate and House Committee Reports focus, in their descriptions of subsection (d), only on whether, and the extent to which, the claim secured by the lien has been allowed. Thus, the Senate Report's first sentence on subsection (d) says: "Subsection (d) provides that to the extent a secured claim is not allowed, its lien is void" unless certain exceptions apply. S. Rep. No. 989, at 68. The House Report states that if a party requests a determination whether a claim is to be allowed, "then the lien is void to the extent that the claim is not allowed." H.R. Rep. No. 595, at 357. Neither statement suggests any congressional intent that the lien be void to the extent that the claim is not treated for distribution purposes as a secured claim.

Reading Section 506(d) to preserve liens securing allowed claims is also reinforced by bankruptcy law's long-standing reluctance to disturb state-law rights in encumbered property and its treatment of such rights as largely distinct from the personal claims against the debtor that the bankruptcy proceeding discharges. *See* pages 17-19, 20-23, *supra*. In addition, the present interpretation respects the limits on Section 722's redemption right. *See* pages 24-26, *supra*. Nor is there even an issue raised by Section 722's reference to the "allowed secured claim," for that reference invokes only Section 506(a): if the claim has been fully allowed, Section 506(a) applies even though Section 506(d) is inapplicable. Finally, this reading of Section 506(d) both eliminates any improper incentive to choose liquidation over reorganization (*see*

pages 33-35, *supra*) and properly denies debtors like petitioner the windfall benefit she claims (*see* pages 23, 32-33, *supra*). For all of those reasons, the court of appeals' holding that Section 506(d) is inapplicable to respondents' lien is properly affirmed under this alternative rationale.

III. If Petitioner's Property Is Covered by Section 506(d), the Amount of the Surviving Lien Should Be Adjusted to Reflect Any Actual Recovery in a Foreclosure.

If, contrary to our submission, Section 506(d) applies notwithstanding the allowance of respondents' claim and the abandonment of the collateral, petitioner still should not reap the benefit of any recovery at a foreclosure sale over and above the value judicially assigned to the property in 1987. On these assumptions, Section 506(a) is properly read to require that the judicially determined value be adjusted to reflect the actual sale price (whether to a third party or to the lienholder), at least as long as there is no specific reason for not adjusting the value, such as substantial prejudice to the conduct or completion of the bankruptcy proceeding. Certainly, in this case, no such prejudice or other reason suggests that the court of appeals was wrong to deny petitioner's request that the judicially determined value of $39,000 be treated as a permanent cap on respondents' interest.

The second sentence of Section 506(a) directs the bankruptcy court to determine the value of collateral "in light of the purpose of the valuation and of the proposed disposition or use of such property." 11 U.S.C. § 506(a). Both the Senate Committee Report and the post-conference legislative statement expressly contemplate that the valuation may change during the course of the proceeding. S. Rep. No. 989, at 68; 124 Cong. Rec. S17411 (daily ed. Oct. 6, 1978). And the leading treatise states: "the statute makes reasonably clear that any valuation of collateral is temporal . . . . The courts have virtually uniformly recognized that the value of the property securing

a claim, and thus the allowed amount of the secured claim, may change during the course of a bankruptcy case." *Collier* ¶ 506.04, at 506-25 (15th ed.) (footnote omitted).[38]

If a foreclosure sale actually yields more for the property than the judicially determined value, whether in a sale to a third party or in a sale to the lienholder making a fair bid in anticipation of future appreciation, that is sufficient reason for a revision in the pre-foreclosure valuation and, hence, in the allowed secured claim—and, therefore, in the amount of the lien left unaffected by Section 506(d). Such an adjustment serves the general aim of valuation: to determine the market value of the collateral. *See Collier* ¶ 506.04, at 506-29 to -30 (15th ed.). It is consistent as well with the recommended practice of using the sale to determine the value in the first place: "If an actual disposition is to occur, regardless of the purpose of the valuation, the value of the collateral should be based on the consideration to be received by the estate in connection with the disposition, provided that the court determines such consideration is fair and was arrived at on an arm's-length basis." *Id.* at 506-27 (footnote omitted). And, of course, this approach serves three important bankruptcy goals: it prevents the debtor from recovering a windfall benefit; in the event of a higher foreclosure price, it gives the other general creditors a larger share of the estate (because the lienholder's unsecured claim is reduced); and it ensures that the lienholder does not suffer an abrogation of his full state-law property right.

To be sure, an adjustment of the amounts of the secured and unsecured claims might, in some cases, be so prejudicial to the orderly completion of the bankruptcy proceeding—particularly, to the distribution to creditors

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[38] Indeed, this general principle should require a new valuation of the collateral on any remand in this case in any event.

—that no adjustment should take place. Quite often, however, there should be no impediment to an adjustment. Most relevant here, the amount of the secured and unsecured claims may have no significance because there may be no distribution to unsecured creditors in any event (and the collateral has been abandoned in "payment" on the secured claim). In such a case, which is this case (*see* note 8, *supra*), altering the collateral value at *any* time should have no disruptive impact on the bankruptcy proceeding. Similarly, if there *is* to be a distribution to unsecured creditors, the adjustment should require nothing more than a subtraction from the previously determined unsecured claim of the lienholder and a corresponding addition to the pool available for distribution to the remaining general creditors. If no distribution has yet occurred, little prejudice should be caused. And even after a distribution, perhaps even after the case has been closed, there might be cases in which it is no substantial burden to adjust the Section 506(a) bifurcation of claims: the Code itself contemplates that cases may be reopened. 11 U.S.C. § 350. *See also* Bankr. Rule 5009.

In short, if the Court concludes that Section 506(d) applies to respondents' lien on petitioner's property, it nevertheless should affirm the court of appeals' holding that petitioner is not entitled, as she has claimed, to limit respondents' interest in the property at a foreclosure sale to the judicially assigned value of $39,000. No reason appears in this record why the collateral value should not be adjusted to reflect the result of a foreclosure sale. Any new argument that there is an impediment to the automatic adjustment of the lien to reflect that sale price should be made initially in the bankruptcy court.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

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